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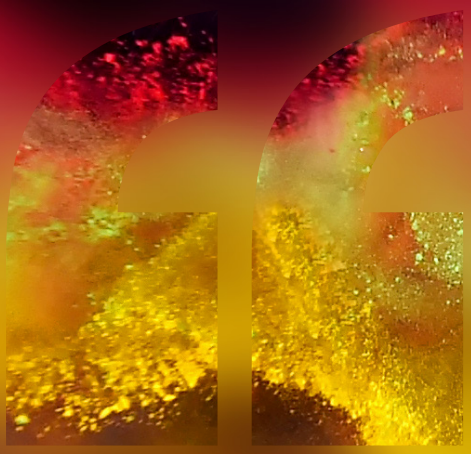
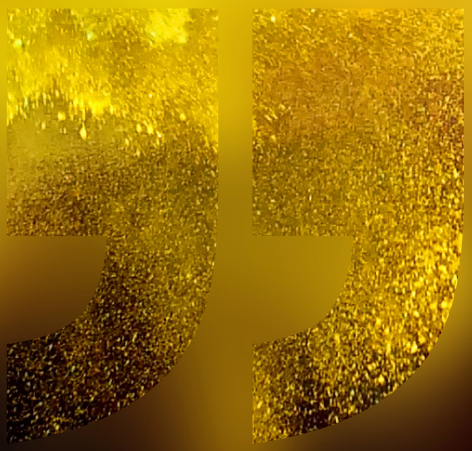


INITIAL COIN OFFERINGS – ASKING THE RIGHT REGULATORY QUESTIONS



– THOUGHT LEADERSHIP

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INITIAL COIN OFFERINGS – ASKING THE RIGHT REGULATORY QUESTIONS

Initial coin offerings or ICOs are growing rapidly. Essentially a method of crowdfunding facilitated through blockchain and cryptocurrency technologies, ICOs are reported to have raised almost $1.3 billion globally from the start of 2017 despite being denounced by some commentators as Ponzi schemes. Companies and financial institutions are keen to explore the possibilities of ICOs – whether as a fundraising method or to cash in by acting as advisers or arrangers – but what are the risks, how are ICOs regulated and how might this change?

Terminology

- An ICO is a fundraising event in which an issuer/operator offers tokens to participants in return for consideration (funds, or as a reward for marketing or referral efforts).
- ICOs are also known as initial public coin offerings, initial token offerings, token launches and token sales, typically due to regulatory differences or marketing or technical distinctions. The terms 'cryptocurrency', 'crypto-token', 'blockchain token' and/or 'token' are sometimes used instead of 'coin'.
- Generally, coins and cryptocurrency are separate blockchains (or decentralised distributed ledgers) which store value or transaction information (eg, Bitcoin, Ethereum, Waves or Digibyte). Tokens are commonly generated by a smart contract system (which often has multi-functionality) that is based on an existing cryptocurrency (for example, Golem which is Ethereum-based and Mobilego which is based on both Ethereum and Waves).
- For simplicity, the term 'token' in this briefing is to be taken as also including coin and cryptocurrency.

The tokens under an ICO will typically entitle holders to a right derived from the underlying asset or business arrangement, for example:

- The right to a profit or asset (such as the distribution of actual profits or through the repurchase and the virtual destruction (termed 'burning') of repurchased tokens which theoretically reduces supply, so increasing the token price).
- A right of use (say of a system or particular service offered by the issuer).
- Voting rights (for example, as a participant of a decentralised currency exchange operated by the issuer).

How does it work?

ICOs are typically announced through online channels such as cryptocurrency forums and websites. Most issuers will provide access online to a white paper describing the project and key terms of the ICO (its economic terms, subscription details, timeline, for example), and providing information on the status of the project as well as the key team members involved.

In the subscription process, the participant generally is required to transfer cryptocurrency to the issuer – typically to one or more designated addresses (an online reference for cryptocurrencies similar to an account number) or online wallets of the issuer. Subscriptions may be completed in minutes. A participant may also be rewarded with tokens by taking certain actions, such as marketing on cryptocurrency forums. Once the ICO is completed, the tokens will be distributed to the participants' designated addresses or online wallets. Issuers may have tokens listed on cryptocurrency exchanges (eg, Poloniex or Bittrex) to trade against other cryptocurrencies to create liquidity and value.

What should you ask?

Here are some questions to consider before deciding whether to participate in an ICO; the regulatory implications are much broader than simply considering whether the tokens issued are regarded as 'currency' or 'securities'. Because blockchain platforms such as Ethereum operate without borders, issuers/operators must carefully structure ICOs to be compliant with regulations across multiple jurisdictions. Similarly, participants and service providers must be mindful of the regulations applicable to their own jurisdictions, including those by virtue of extra-territorial effect.

- Who is the issuer and in which jurisdiction(s) will it operate?
- Who are the service providers, what are the services being provided, and where will they perform their service operations?
- Who are the participants of the ICO and in which jurisdiction(s) are they based?
- How and by what means could participants acquire the tokens? For example, by crowd sale with subscription through payment of other cryptocurrency, or by performance of certain actions?
- What is the asset or business arrangement underlying the tokens? What rights does the participant acquire from holding the tokens, for example, a right to profit, right to use or voting rights?
- What are the economics behind the tokens (for example, how can the

participant expect to obtain a return, monetary or otherwise, if at all)?

- What are the underlying operations of the issuer (for example, is it a business venture or new technology solution) and how is it structured/managed/operated (for example, fully decentralised with no formal legal structure or through a legal vehicle)?

Regulatory analysis

Taking into account the answers to the questions above and any other relevant circumstances, a regulatory analysis can then be undertaken for each of the relevant jurisdictions (ie, those of the issuer, the service providers and the participants). Some points to note:

- Think broadly about what could impact your position. For example, issuers should always consider the regulations of each potential participant's jurisdiction as they may affect how an issuer may market to or accept subscriptions from participants.
- Each party involved is likely to have a different perspective. For example issuers may be interested to know which jurisdiction is the most regulatory 'friendly' for it to perform the underlying operations or to host the ICO; a service provider may be interested to know whether the services it is providing are regulated services, and the participants would want to confirm that it is legal for them to participate in the ICO.
- What is the legal nature of the tokens being offered under the ICO in the relevant jurisdiction? For example, would it be categorised as any of the following in accordance with the laws of each relevant jurisdiction and what are the regulatory implications? In many jurisdictions this is likely to vary depending on the exact terms of the tokens being issued and the nature of the treatment of these legal concepts in that jurisdiction.
  - Currency
  - Commodity
  - Security
  - Property
  - Structured product or derivative contract
  - Foreign exchange contract
  - Loan
  - Deposit
  - Collective investment scheme/fund
  - Insurance product
  - Other regulated investment contract or product
- Could any circumstances arise that would trigger regulatory licensing/registration/authorisation requirements and/or other regulatory compliance requirements with respect to the nature of the tokens being offered under the ICO and the proposed role of each of the issuer and each service provider and participant under the ICO? Have relevant requirements, such as the obligation to undertake anti-money laundering and know-your-client checks, been complied with? The following (non-exhaustive) list of activities may trigger such requirements, although again this will vary depending on the jurisdiction and specific circumstances:
  - Dealing/marketing/offering/advisory activities relating to securities or any other regulated contract or product
  - Money lending activities
  - Deposit taking activities
  - Operation of stored value facilities
  - Operation of securities, commodity or other regulated exchange
  - Management of a collective investment scheme/fund
  - Remittance and/or money changing activities
  - Insurance brokerage activities
  - Business operation/establishment
  - Handling of personal data/privacy
  - Tax presence
  - Intellectual property
  - Gambling

There is no one-size-fits-all solution for designing a regulatory analysis framework for ICOs and the regulatory analysis we have outlined is by no means exhaustive. The regulatory analysis will be affected by the laws and regulations of the relevant jurisdictions, the nature of the crypto-world and its ongoing evolution, the usage and meaning of the term ICO, and the fact that the structure and nature of ICOs may change or evolve very quickly.

WHAT ARE REGULATORS DOING?

While no jurisdiction has yet implemented a regulatory framework specific to ICOs and/or tokens, regulators globally are increasingly focused on them and a number have issued announcements, guidance or comments. The general regulatory theme is that activities around ICOs and/or tokens may constitute regulated activities in the relevant jurisdiction under the existing local regulatory regime depending on the facts of the case, and regulators are closely watching this space. Some highlights of the international regulatory framework and some recent examples of regulator engagement globally are set out below.

FOCUS ON KEY JURISDICTIONS

Australia

In light of increasing ICO activity in Australia, the Australian Securities and Investments Commission (ASIC) released an information sheet on ICOs in September 2017 designed to give guidance about the potential application of the Australian Corporations Act to businesses that are considering raising funds through an ICO. This confirms that the legal status of an ICO in Australia will depend on how the ICO is structured and operated and the rights attached to the coin / token being offered. If the ICO has characteristics typically associated with a security under the Australian Corporations Act then it will most likely be regulated as such. If the ICO has no connection to the elements of a security under the Australian Corporations Act then while the ICO may be outside of the regulatory umbrella of the Australian Corporations Act, it will still be subject to general law and Australian consumer law relating to the offer of services or products.

ASIC's information sheet is useful in helping to more formally delineate the key areas of consideration that, at a minimum, potential issuers of ICOs should have on their radar. For example, whether their ICO has the characteristics of a managed investment scheme, an offer of shares or a derivative. For those providing the platform on which such coins / tokens are trading (assuming the ICO in question is a financial product) consideration also needs to be given as to whether a financial market is being operated by the platform.

This reflects our experience of the questions issuers are considering. Either looking to ensure that the ICO will be outside of the regulatory sphere of the Australian Corporations Act or acknowledging the nature of the proposed ICO will put it under the purview of the Australian Corporations Act and thus looking to ensure that the Australia Corporations Act requirements are understood and complied with.

More widely, the Australian Government's Report of the Statutory Review of the Anti Money Laundering and Counter-Terrorism Financing Act 2006 and Associated Rules and Regulations (the Report) identified that the regulation of convertible digital currencies must be a priority action for the Australian Government. The Australian Government has since adopted the Report's recommendations and tabled proposed legislation in Parliament, which seems to have bipartisan support. The proposed legislation will be directed to minimising the perceived money laundering and terrorist financing risks associated with the growing use of digital currencies in the Australian economy. Despite the focus being placed on exchange providers, it is arguable that the concept of 'currency exchange' may be wide enough to also capture coin issuers, who would need to register as exchanges. It is too early to tell whether this will be the practical impact of the proposed legislation.

France

Given the absence of specific regulation of ICOs and, more broadly, blockchain in France so far (though, pending implementing measures, a legal framework emerged in 2017 for DLT technology dedicated to unlisted securities and fund units) the French *Autorité des marchés financiers* (AMF) published, at the end of October, a discussion paper aimed at collating the views of market participants and other stakeholders on the different possible regulatory frameworks applicable to ICOs. Consultation is open until 22 December 2017. In the discussion paper, the AMF identifies three potential options for regulation: (i) maintain a regulatory status quo and establish best practice guidelines (eg re disclosure, KYC, confirmations, organisation of the issuer, standards of the issuer, control framework, etc); (ii) extend the scope of existing texts to treat ICOs as public offerings of securities, thus submitting them to prospectus requirements; and (iii) adopt an ad hoc regulation tailored to ICOs based on pre-authorisation regime whereby the issuance would need to obtain authorisation prior to any marketing in France. The AMF could assess the marketing application against a number of criteria including investor disclosures, information on the issuer, the balance of information, description of returns, use of blockchain and segregation of funds raised.

The AMF also launched its UNICORN (Universal Node to ICO's Research & Network) programme with a view to support ICOs initiators (French or foreign entrepreneurs and their advisors) and work as a regulatory think tank for all new fundraising activity based on cryptocurrencies and blockchain technology.

Germany

The German Federal Financial Supervisory Authority (BaFin) has published a guidance note on virtual currencies on its website. BaFin qualifies virtual currencies as units of account (Rechnungseinheiten), which generally qualify as financial instruments within the scope of the German Banking Act, regardless of what software or encryption technologies have been used. Tokens issued under an ICO are likely to be classified as virtual currencies for this purpose.

In BaFin's view, virtual currencies are not legal tender and so are neither currencies nor foreign notes or coins. Virtual currencies also do not usually qualify as e-money within the meaning of the German Payment Services Supervision Act (Zahlungsdiensteaufsichtsgesetz) – in BaFin's view they do not represent any claims on an issuer, as in most cases there is no issuer of coins. However, BaFin takes a different view for digital payments with virtual currencies which are backed by a central entity that issues and manages the units, which may be the case with certain ICO issuances.

The simple use of virtual currencies as a substitute for cash or deposit money, to participate in exchange transactions as part of the economic cycle does not in BaFin's view trigger a licencing requirement in Germany. The "mining", purchase or sale of virtual currencies would also not trigger a licencing requirement. However, in certain additional circumstances, commercial handling of virtual currencies may trigger a licencing requirement under the German Banking Act. In this respect, every ICO would need to be assessed on a case by case basis.

In November 2017 BaFin also published a consumer warning regarding the risks associated with ICOs. This warning does not have any regulatory impact and does not provide further information on the regulatory status of ICOs in Germany. However, it shows that BaFin has ICOs on its radar and closely monitors any negative developments. In particular BaFin addresses the insufficient information provided compared to regulated prospectuses and the systemic vulnerability of ICOs to fraud, money laundering and terrorist financing.

Hong Kong

The regulators in Hong Kong have adopted a technology–neutral regulatory approach and are seeking to develop and implement a regulatory framework and requirements based on the intrinsic characteristics of the relevant activities or transactions and the risks arising from them.

The Hong Kong Securities and Futures Commission (SFC) has issued a press release on 5 September 2017 regarding use of ICOs to raise funds in Hong Kong. The SFC noted that while digital tokens offered in typical ICOs are usually characterised as a "virtual commodity" (which is consistent with the position of the Hong Kong Monetary Authority (HKMA) which has previously reiterated that Bitcoin is not a legal tender but a virtual "commodity"), depending on the terms and features (e.g. whether the ICO provides equity or debt features, or the token proceeds are managed collectively for returns by scheme operators), such tokens may be considered "securities" and accordingly will be subject to the securities laws of Hong Kong.

In this respect, where the digital tokens involved in an ICO fall under the definition of "securities", dealing in or advising on such tokens, managing or marketing a fund investing in such tokens or operating a cryptocurrency exchange involving trading of such tokens may be considered a "regulated activity" and may potentially trigger Hong Kong licensing / product authorisation requirements.

Japan

Following amendments becoming effective in April 2017, cryptocurrencies are defined in Japan's Payment Services Act (PSA) as "Virtual Currencies". Sale and purchase of, and exchanging, Virtual Currencies (or acting as an intermediary in respect of such activities) are regulated as a Virtual Currencies Business Operator and require registration with the Financial Services Agency of Japan (JFSA). JFSA has not issued any guidelines concerning ICOs other than the PSA . It is not a negative signal for ICOs in Japan. However, it is advisable to consider carefully, based upon actual facts and details of relevant ICOs, (i) whether an issuer or other service

ESMA highlights ICO risks

On 13 November 2017 the European Securities and Markets Authority (ESMA) alerted investors and firms involved in ICOs to the risks involved. ESMA is concerned that investors may not be aware of the high risks they are taking such as the volatility of the price of the coins or tokens and that they may not benefit from the protection of EU laws and regulations where ICOs fall outside their scope. It urges firms involved in ICOs to give careful consideration to whether their activities constitute regulated activities as any failure to comply with the applicable laws will constitute a breach.

providers could be categorised as a Virtual Currencies Business Operator (when the subscription price of the ICO digital token would be paid in cryptocurrencies, "exchanging" of cryptocurrencies could be at issue), (ii) whether the digital tokens issued in the ICO would be categorised as "Virtual Currencies" under the PSA and (iii) whether such digital tokens would be categorised as conventional securities under the existing securities regulations in Japan, especially where such tokens grant equity type rights to subscribers. If the digital tokens are considered to be conventional securities, traditional securities regulations would apply to the ICO. JFSA will monitor markets of Virtual Currencies and ICO activities to consider whether any regulatory actions would be required or appropriate.

People's Republic of China

In September 2017 a cross-agency working committee led by the People's Bank of China issued a Circular on Preventing Risks related to Initial Coin Offerings, categorising ICOs as an unauthorised and illegal public fundraising activity. This is the first time that Chinese regulators have set out their stance in respect of ICOs in China. The circular stated that ICOs may constitute a number of crimes such as illegal quasi-currency instruments offering, illegal securities offering, illegal fundraising, financial fraud and pyramid selling schemes. The digital tokens used in ICOs are not currencies issued by competent authorities and may not be circulated or used as currency on the market. The circular stated that all ICOs in China should be halted immediately, and issuers that have completed ICOs should provide refunds to investors. Digital token financing/trading platforms (including websites and APPs) may be closed or barred from operating, and the business licenses of entities running such platforms may be revoked. Financial institutions and non-banking payment institutions are prohibited from directly or indirectly providing any ICOs-related services.

Recently, the relevant Chinese regulators (in particular, PBoC) have taken a number of regulatory actions related to Bitcoin usage including conducting on-site inspections of domestic Bitcoin trading platforms, summoning the senior management in charge of the relevant trading platforms for meetings, and urging these platforms to arrange self-surveys and take rectifying measures accordingly. These demonstrate the Chinese regulators' stance of increased supervision and oversight in this area.

Poland

In November 2017, the Polish Financial Supervision Authority (Komisja Nadzoru Finansowego, KNF) issued a communiqué on Initial Token Offerings (ITOs) and Initial Coin Offerings (ICOs). In the communiqué the KNF stated that making investments in tokens, under ICOs, is highly risky. The KNF noted that actions in the scope of ICOs may potentially be subject to a number of legal requirements, including those pertaining to the preparation of an issue prospectus and public offering, the creation and managing of alternative investment funds and protection of investors, although they must be assessed on a case-by-case basis. In the communiqué the KNF drew the attention of potential investors and entities interested in implementing projects of this kind to the specific and significant risks related with ICOs. The KNF noted that potential buyers should be aware, in particular, of the possibility of losing their entire invested capital and possible lack of legal protection. The KNF explained that investors who are contemplating investing in ICOs are exposed to, in particular, the following risks: unregulated area susceptible to fraud and other irregularities; high risk of the loss of all or a portion of the funds invested; lack of information, inadequate documentation; lack of the possibility of "exiting" from the investment and very high fluctuations of value; defects of the technology used.

Russia

While the initial attitude of the Russian Government to cryptocurrencies was fairly cautious (with some officials even suggesting it would be a criminal offence to use cryptocurrencies), over the last 18 months there has been a considerable shift in mindset. Although Russia has not issued any specific regulations on cryptocurrencies yet, the issue is widely debated both by the Government and in the business community, with more and more businesses expressing interest in ICOs and a willingness to accept payments in cryptocurrencies. Accordingly, in June 2017 the Central Bank of Russia has together with the Ministry of Finance announced that draft legislation is being developed to define the legal and tax status of cryptocurrencies, and although limited information is available at this stage, it appears that the intention is to treat cryptocurrencies as "quasi-commodities".

Singapore

In the wake of an increase in the number of ICO offerings in Singapore, MAS issued a clarification on the regulatory position on digital token offerings on 1 August 2017 as well as a joint consumer advisory (with the Commercial Affairs Department of the Singapore Police Force) on investment schemes involving digital tokens and virtual currencies on 10 August 2017. On 14 November 2017, MAS published a further guide on the application of Singapore securities laws to offers or issues of digital tokens in Singapore.

MAS stated in the guide that the offer/issue of digital tokens in Singapore may be regulated if the digital tokens constitute capital markets products under the Securities and Futures Act (SFA). This would include securities, futures contracts, and contracts or arrangements for the purposes of foreign exchange trading or leveraged foreign exchange trading. Intermediaries who facilitate offers or issues of digital tokens, such as operators of platforms on which offerors of digital tokens may make primary offers or issues of digital tokens, operators of platforms on which digital tokens are traded, and persons who provide financial advice in respect of digital tokens, may be required to hold a licence to carry on such activities.

MAS had previously stated in March 2014 (and it was recently repeated in a parliamentary response) that virtual currencies are not regulated, however, MAS has clarified that they view a virtual currency (functioning as a medium of exchange, a unit of account or a store of value) as only one particular type of digital token. Where digital tokens represent ownership or a 'security' interest over an issuer's assets or property, for example, such tokens may be considered an offer of shares or units in a collective investment scheme under the SFA. Digital tokens may also represent a debt owed by an issuer and so be considered a debenture under the SFA. As such, the regulatory treatment of any token and, if applicable, the related ICO offering would need to be analysed carefully against existing regulation based on the terms of the token and the ICO and the activities and role of the various players using the framework discussed above.

The consumer advisory advised the public to exercise due diligence to understand the risks associated with ICOs and investment schemes involving digital tokens and virtual currencies, and also set out a non-exhaustive list of such risks. It further went on to advise the public to report any suspected cases of fraudulent investment schemes involving digital tokens to the police.

MAS had stated in March 2014 that intermediaries in virtual currencies would be regulated for money laundering and terrorist financing risks, and more recently in 2016 published a statement that it is working on proposed regulations to be introduced for virtual currency intermediaries operating in Singapore. MAS also stated in its 1 August 2017 clarification that it is currently assessing how to regulate money laundering and terrorist financing risks associated with activities involving digital tokens that do not function solely as virtual currencies. MAS has clarified in the guide that the requirements under the Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act (Cap. 65A), the Terrorism (Suppression of Financing) Act (Cap. 325) and the various regulations giving effect to United Nations Security Council Resolutions, could apply whether or not the digital tokens perform functions within MAS's regulatory purview. In addition, where the digital tokens perform functions within the MAS's regulatory purview, the MAS Notices on Prevention of Money Laundering and Countering the Financing of Terrorism may apply.

In a related development, MAS issued a policy consultation paper in August 2016 proposing wide-ranging changes to the regulatory regime for payments in Singapore, including the introduction of an activity-based payments regulatory framework. The new payments framework will include rules to address money laundering and terrorism financing risks relating to the dealing or exchange of virtual currencies for fiat or other virtual currencies.

Spain

While the Bank of Spain has publicly stated the importance of providing an appropriate legal framework for virtual currencies, no comprehensive rules or guidelines regarding ICOs have yet been published. Accordingly, any ICO related activity in Spain requires careful consideration of payment services and anti-money laundering regulations (within the context of the EU Directives) as well as other general financial regulations.

United Arab Emirates

In the UAE, ICOs are currently being undertaken without specific regulation but subject to certain licensing requirements where the units offer a right in an underlying commodity in which trading does require a licence (gold being the example applied to date in the UAE). However, there has been some controversy regarding whether the UAE Central Bank intends to regulate "virtual currencies". In January 2017, the Central Bank published a new licensing framework for stored value facilities offering certain digital payment services, due to be implemented by 1 January 2018. This framework states "All Virtual Currencies (and transactions thereof) are prohibited". Following confusion in the market, with several ICOs having already been publicised, the Governor of the Central Bank, issued a statement in February 2017 that the regulations "do not cover Virtual Currency" and "do not apply to Bitcoin or other cryptocurrencies, currency exchanges, or underlying technology such as blockchain". It was noted that new regulations will follow. No action has been taken in respect of subsequent unlicensed ICOs.

It is expected that a more thorough regulation covering cryptocurrencies will be issued in the near future by the Central Bank, perhaps as part of the implementing measures for the 2017 licensing framework expected later this year. Also, in November 2016, the Supreme Legislation Committee for the Government of Dubai announced discussions on future legislation related to cryptocurrencies in cooperation with the Dubai Electronic Security Center. This could result in regulations specific to the Emirate of Dubai, in addition those of the Central Bank (which would be at a Federal level across the UAE). Most recently, the Governor of the UAE Central Bank is reported to have said the Central Bank considers digital currencies pose high risks to investors and present money laundering risks. The comments may have sought to clarify that the Central Bank is not regulating a number of digital currency exchanges and ICOs marketed in the UAE.

In the financial free zones, the Dubai Financial Services Authority (DFSA) has issued a warning statement to investors that crypto currency investments should be treated as high risk and with unique risks which may be difficult to identify. The DFSA clarified that it does not regulate ICOs and also that it would not license firms undertaking such activities.

In the Abu Dhabi Global Market, the Financial Services Regulatory Authority (FRSA) has gone further and issued regulatory guidance to clarify for investors that whilst ICOs (or crypto currencies) would not be regulated in themselves, elements of certain ICO offerings, which can include activities of operating an exchange, offering securities or units in a fund and dealing in derivatives, can fall within the regulatory perimeter. In such case, the activities would be regulated in the usual way. The FRSA also confirmed that many aspects of ICOs, including spot transactions in virtual currencies, may not be regulated activities and investors must be aware of the lack of regulatory oversight.

United Kingdom

The United Kingdom Financial Conduct Authority (FCA) has issued a consumer warning about the risks of ICOs. It says "ICOs are very high-risk, speculative investments." It adds that whether an ICO falls within the FCA's regulatory boundaries or not can only be decided case by case and states: "Businesses involved in an ICO should carefully consider if their activities could mean they are arranging, dealing or advising on regulated financial investments. Each promoter needs to consider whether their activities amount to regulated activities under the relevant law. In addition, digital currency exchanges that facilitate the exchange of certain tokens should consider if they need to be authorised by the FCA to be able to deliver their services." The FCA had previously noted in its April consultation on the potential for the future development of distributed ledger technology in regulated markets, that "depending on how they are structured, they may, therefore, fall into the regulatory perimeter". As the FCA has indicated, there are a number of regulated activities that issuers and participants in ICOs would need to consider and navigate, including deposit-taking and e-money issuance, CFDs and derivatives as well as the broad definition of what constitutes a collective investment scheme and applicable anti-money laundering regulations.

United States

In the United States, an ICO is potentially subject to numerous laws and regulations, depending on the location of the issues, the entities or persons to whom it is marketed and the type of services provided or proposed to be provided. Generally, an offer and sale of tokens may be subject to the U.S. securities laws and the jurisdiction of the U.S. Securities and Exchange Commission (SEC) if an investment of money is made with an expectation of profits arising from a common enterprise that depends solely on the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

In July 2017, the SEC issued an investigative report on whether the digital tokens issued in an Initial Coin Offering (ICO) by an entity known as The DAO, co-founded by a German corporation called Slock.IT, were in fact securities under the federal securities laws. As a virtual decentralized autonomous organization built on Ethereum's blockchain and functioning by means of smart contracts technology, The DAO itself did not conduct active business operations or control any business assets. Instead, it existed as a means to channel the proceeds of token sales into funding various real-world "projects" to develop products or provide services that would be undertaken on a for-profit basis by independent contractors ("Contractors"). Project proposals, written in the form of smart contracts, would be submitted by Contractors to a group of individuals called "Curators". The Curators would then vet the proposal in the exercise of their subjective judgment. If the Curators approved of the project proposal, the proposal would then be "whitelisted", i.e. submitted to a vote of token holders. If a majority voted in favour of the project proposal, then the project would be carried out by the Contractors and token holders would receive a share of profits ("rewards") as a return on their investment. The Curators chosen by Slock.IT had the discretionary power to change the token holder voting thresholds required to approve of projects. Given this structure and its visible similarity to a traditional capital raising relationship, it is perhaps unsurprising that the SEC determined the tokens issued by The DAO were securities subjecting The DAO to its jurisdiction. The SEC was careful to note, however, that the analysis as to whether a token or other digital asset is a security depends on a careful examination of the particular facts and circumstances, including the economic realities of the transaction, and that leaves open the possibility that the SEC does not consider all tokens to be securities.

In the ICO context, some market observers have asserted that coins or tokens which have features different from those of The DAO tokens might avoid characterization as securities. In particular, ownership of so-called "utility tokens" imbued with genuine functionality within a software application or ecosystem arguably would be motivated primarily by a desire to engage in personal consumption (making use of the tokens' functionality), rather than for the purpose of investment. Where ownership of a utility token is based on a desire to use the token's functionality, rather than a desire to achieve profits from investment (as would be the case for tokens which are securities), it would appear that the expectation of profits does not derive from the active efforts of others, but rather derives from the active efforts undertaken by the token holders themselves, thus avoiding application of the Howey test. However, the idea that utility tokens are not securities has not been endorsed by the SEC, and there is currently no applicable regulatory guidance on the issue.

In October, another regulator, the U.S. Commodity Futures Trading Commission (CFTC), through its fintech division, LabCFTC, released its first-ever "Primer on Virtual Currencies" in which it articulated what some observers consider to be an expansive view of its jurisdiction over the digital assets space, i.e., that both ICO tokens and cryptocurrencies can constitute "commodities" and thus potentially be subject to its authority. Somewhat paradoxically, given the SEC's jurisdiction over securities and the obvious resemblance ICO tokens appear to bear to securities, the CFTC announced its view that "[t]here is no inconsistency between the SEC's analysis [in its report on The DAO] and the CFTC's determination that virtual currencies are commodities and that virtual tokens may be commodities or derivatives contracts". However, one reading of what the CFTC could mean by this statement is that, if utility tokens are not securities under the Howey test due to the fact that their ownership derives from a motive to make use of their functionality for personal consumption, then they could be of the nature of "commodities". The CFTC traditionally has jurisdiction over all commodities, including financial ones, except for movie theatre box office receipts and onions. Therefore, utility tokens that are not securities could be "commodities" that would then potentially subject them to certain aspects of CFTC jurisdiction. Although the traditional view is that the CFTC's jurisdiction is over financially-settled commodity futures transactions, and not over spot or forward (physically-settled) commodities transactions, the Dodd-Frank Act, which added new §2(c)(2)(D) to the Commodity Exchange Act, notably increased the CFTC's jurisdiction over the latter in cases involving a real or a constructive lack of actual delivery within 28 days, retail investors and the use of leverage. In an enforcement case involving the cryptocurrency exchange Bitfinex in 2016, the CFTC ruled that delivering Bitcoins to a retail investor's multi-signature digital wallet did not constitute "actual delivery" where the exchange refused to provide the private key needed for the investor to withdraw Bitcoin from the wallet, until the investor repaid the margin loan the borrower had taken out from the exchange to finance the Bitcoins' purchase price. Therefore, where ICO and token sales involve retail investors, an actual or a constructive lack of physical settlement within 28 days, and the use of leverage, the CFTC is another regulator that may be prepared to exercise its statutory authority over the space.

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